THE OFFICE OF REGULATORY STAFF

DIRECT TESTIMONY

OF

CAREY M. FLYNT

May 27, 2007

DOCKET NO. 2008-5-G

ANNUAL REVIEW OF PURCHASED GAS ADJUSTMENT AND GAS PURCHASING POLICIES OF SOUTH CAROLINA ELECTRIC AND GAS COMPANY

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IN RE: ANNUAL REVIEW OF PURCHASED GAS ADJUSTMENT AND GAS PURCHASING POLICIES OF SOUTH CAROLINA ELECTRIC AND GAS COMPANY

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Carey M. Flynt. My business address is 1441 Main Street, Suite 300, Columbia, South Carolina 29201. I am employed by the State of South Carolina as the Program Manager of the Gas Department for the South Carolina Office of Regulatory Staff (“ORS”).

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Business Administration, with a major in Accounting from the University of South Carolina in Columbia in 1975. I was employed at that time in the electric and gas utility industry and gained twenty-five years of experience in this field. In mid October 2004, I joined ORS in my present position. I have testified on numerous occasions before the Public Service Commission of South Carolina (“Commission”) in conjunction with natural gas issues.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony will present ORS's findings and recommendations for South Carolina Electric and Gas Company ("SCE&G") or ("Company") regarding:

1) The Company's policies for the purchases of natural gas commodity supplies and capacity from upstream interstate pipelines for transportation and storage assets during the historical twelve month review period of March 2007 through February 2008, as well as the Company's plans for the upcoming winter season;

2) the operation and continuation of the industrial sales program rider ("ISPR");

3) the administration of the purchased gas adjustment clause ("PGA");

4) the hedging program;

5) the proposed municipal franchise fees accounting and crediting method; and

6) rate 35 Transportation and Standby Sales Service tariff.

Q. WHAT ARE ORS'S FINDINGS WITH REGARD TO THE COMPANY'S GAS PURCHASING POLICIES DURING THE REVIEW PERIOD?

A. As set forth in Docket 2006-5-G and Commission Order No. 2006-679 dated November 13, 2006, SCE&G ceased receiving bundled supply, upstream pipeline transportation capacity and storage, and liquefied natural gas ("LNG") service from South Carolina Pipeline Corporation ("SCPC") effective November 1, 2006. During this review period, SCE&G was directly responsible for purchasing its own natural gas commodity supplies from multiple sources, managing its own contracts with three (3) upstream interstate pipelines for firm transportation and storage capacity assets, including Southern Natural Gas Company ("Southern"), Transcontinental Gas Pipeline Corporation ("Transco") and Carolina Gas Transmission Corporation ("CGTC"), as well as operating the Company's two (2) LNG facilities. It is ORS's finding that SCE&G was able to purchase physical natural gas commodity supplies and manage its transportation and storage capacity assets and operate its LNG facilities, to meet its customers' needs and provide reliable service at costs consistent with Commission approved tariffs.

Q. PLEASE DESCRIBE SCE&G'S PRACTICES WHICH ARE INTENDED TO ENSURE THAT NATURAL GAS SUPPLIES AND CAPACITY ASSETS ARE READILY AVAILABLE TO FIRM CUSTOMERS DURING EXTREMELY COLD WEATHER.

A. ORS met with SCE&G representatives on numerous occasions regarding the management of its supply, transportation and storage capacity assets. ORS reviewed the Company's contract levels for supply, interstate capacity for firm transportation and storage service, and the operation of its LNG facilities. ORS believes SCE&G met its firm customers' needs in a reliable manner during the review period. It is also ORS's opinion that SCE&G's plans demonstrate the Company is prepared to meet next winter's projected firm customers' requirements in a reliable manner. In addition, SCE&G operates under an end user curtailment plan previously approved by this Commission. The curtailment plan limits purchases of natural gas by interruptible customers to a level that will not jeopardize the Company's obligation to serve its firm customers. Curtailments are determined by the category of service that a customer is purchasing under and identified in the Commission approved General Terms and Conditions accompanying each industrial customer's contract. On rare occasions, supplemental deliveries of natural gas may be required to prevent irreparable injury to life or property, including environmental emergencies. These deliveries, defined as Emergency Service, must first be approved by the Company and are exempt from curtailment.

Q. DOES ORS BELIEVE THE COMPANY'S ISPR OPERATED PROPERLY AND SHOULD THE ISPR BE CONTINUED?

A. Yes. ORS found that the ISPR operated properly and should be continued. This type of program or mechanism is required for a natural gas utility to compete effectively with alternate fuels in the industrial market. The Commission, in Order No. 83-876 dated December 28, 1983 in Docket No. 83-128-G, approved SCE&G's use of a Temporary Gas Cost Rider and most recently modified in Order No. 2005-619. During the review period, SCE&G's ISPR customers' needs were satisfactorily supplied by SCE&G. The ISPR has been regularly reviewed and consistently upheld in each annual PGA proceeding since 1988. ORS continues to support this program which provides benefits for all customers.

Q. PLEASE DESCRIBE THE COMPANY'S GAS COST RECOVERY PROCEDURES APPROVED BY THIS COMMISSION.

A. The Commission approved SCE&G's gas cost recovery mechanism in Order No. 2005-653, dated November 8, 2005. In that order, the change to a two-part cost of gas recovery mechanism was approved. That mechanism involves: 1) a commodity component which is calculated to recover the commodity cost of gas purchased; and 2) a demand component which is calculated to recover the associated capacity cost of ensuring firm gas supplies can be delivered into SCE&G's system. The demand charges include the fixed charges by upstream pipelines for transportation and storage services. Most recently, in Order No. 2007-595, dated September 6, 2007, the Commission approved the current "Purchased Gas Adjustment, Firm Gas Only" tariff sheets submitted by the Company to correct and clarify the written description of the PGA formula.

Q. PLEASE DISCUSS THE OPERATION OF THE TWO-PART COST OF GAS RECOVERY MECHANISM.

A. All firm customers are charged the same Firm Commodity Benchmark cost. However, the Demand Charge cost component is calculated for each customer class (Residential, Small/Medium General Service, and Large General Service) based on a fifty-fifty percent (50%-50%) weighting of Peak Design Day Demand ("PDDD") and Annual Forecast Sales volumes. In computing the Demand Charge component for the firm customers, seventy-five percent (75%) of the revenue generated from capacity release of upstream assets, as well as net revenues from interruptible sales and transportation service are credited against the demand charges. Added together, these two components, (i.e. the commodity and demand costs) equal the PGA factor for each firm customer class.

Q. PLEASE DISCUSS THE CALCULATION OF THE MONTHLY OVER OR UNDER COLLECTION BALANCES OF GAS COSTS FOR FIRM CUSTOMERS.

A. The Company calculates monthly over or under collection balances separately for the Firm Commodity Benchmark and for the Demand Charge components. Each customer class carries forward its own net balance of over or under collections monthly. These calculations are filed with the ORS each month and ORS presents its findings in each PGA proceeding.

Q. DOES ORS BELIEVE THE CURRENTLY APPROVED PURCHASED GAS ADJUSTMENT CLAUSE METHODOLOGY WHICH ALLOCATES DEMAND COST TO THE FIRM RATE CLASSES SHOULD BE CONTINUED?

A. Yes. The current Commission approved allocation method is fair and reasonable and should be continued.

Q. DURING THE REVIEW PERIOD, DID SCE&G FILE WITH THE COMMISSION MONTHLY CHANGES IN THE PGA FACTORS RESULTING FROM THE TWELVE (12) MONTH ROLLING FORECAST OF GAS COSTS?

A. Yes. Under the provisions of Order No. 2006-679, SCE&G is allowed to make monthly adjustments in its PGA factors as supplier or capacity gas costs change after the Company completes an updated monthly forecast if there is a “material difference” for any customer class equal to or greater than $0.01 per therm. In this review period, the Company filed for changes in its PGA factor in nine (9) of the twelve (12) months.

Q. WHAT IS THE OPINION OF ORS REGARDING SCE&G’S PGA FACTORS BEING CALCULATED EACH MONTH ON A ROLLING TWELVE (12) MONTH BASIS AND THE CONTINUATION OF THIS METHOD?

A. ORS believes SCE&G’s computation of its PGA on a rolling twelve month forecast and allowing changes to the PGA factors on a monthly basis should be continued. With the current volatility in the price of natural gas supplies, this method allows the flexibility to possibly avoid an accumulation of a large twelve (12) months over or under collection balance. This method offers protection from extreme rate changes at the end of a twelve (12) month review period, when PGA changes previously were made. This method is beneficial to both the Company and its firm customers.

Q. WHAT ARE ORS'S FINDINGS REGARDING THE COMPANY'S PURCHASED GAS ADJUSTMENT CLAUSE FOR THE REVIEW PERIOD?

A. ORS finds that, except for the adjustments described in witness Barnette's testimony, SCE&G administered and recovered its gas costs during the review period in a manner consistent with the current Commission approved tariffs and Commission Orders. Also as discussed in the testimony of Company witness Mr. James Swan and ORS witness Mr. Roy Barnette, ORS supports the Company's accounting treatment for prepayments and collections related to municipal franchise fees and the crediting of accumulated balances in certain prepayment accounts to the residential and small/medium general service customers through the cost of gas demand calculations. This crediting method through the gas cost demand component provides for the exclusion of the credit to the large industrial **customers**, wh**o normally** do not pay these fees.

Q. PLEASE DISCUSS SCE&G'S HEDGING PROGRAM.

A. In ORS's testimony during last year's PGA docket, ORS expressed concern that SCE&G's hedging program had added over seventeen and one half million dollars ($17.5M) to the cost of gas for four (4) months during the shortened six (6) month review period. However, ORS was mindful that several conditions had resulted in insufficient information to evaluate the long term effectiveness of SCE&G's hedging program at that time. These factors included: 1) the shortened review period; 2) the Company having the majority of its hedges placed by SCPC on SCE&G's behalf using the Original Kase model; 3) the implementation of the new SCE&G hedging models and techniques, including the Kase ezHedge model and dollar cost averaging; and 4) allowing SCE&G to hedge up to a maximum of fifty percent (50%) of its estimated gas purchases for its firm customers, which was lower than SCPC's maximum percentage of seventy-five percent (75%). ORS was aware that this 2008 PGA proceeding would include a normal annual twelve (12) month review period from which we believed more information would be available to further evaluate the program.

Q. WHAT WERE THE RESULTS OF SCE&G'S HEDGING PROGRAM?

As shown in Mr. Roy Barnette's testimony in Exhibit RHB-5, the balance resulting from SCE&G's hedging program during this review period, March 2007 through February 2008, has added approximately nineteen million dollars ($19M) to the Company's cost of gas.

SCE&G's hedging program resulted in a cumulative addition to SCE&G's customers' cost of gas from inception, in November 2006, through February 2008 of more than thirty-six and one half million dollars ($36.5M).

Q. NOW THAT THE RESULTS FOR A LONGER PERIOD ARE KNOWN, DOES ORS HAVE ANY RECOMMENDED CHANGES TO THE COMPANY'S HEDGING PROGRAM?

A. Yes.

1) SCE&G's approved hedging program allows the Company to hedge up to a maximum of fifty percent (50%) of the estimated gas purchases for its firm customers, derived by averaging firm purchases for the previous three (3) years. ORS recommends the maximum percentage of volumes that may be hedged be reduced to twenty-five percent (25%).

2) SCE&G utilized the Kase ezHedge model and the dollar cost averaging technique. After reviewing the results, ORS recommends the Company eliminate

the use of the Kase ezHedge model, along with all operating and administrative costs associated with this model. ORS does not object to the Company continuing to use the dollar cost averaging technique.

3) ORS proposes to reduce the number of forward months the Company can place hedges from eighteen (18) months to twelve (12) months.

4) ORS recommends the Company liquidate or "cash out" its outstanding positions for the last six (6) months of the eighteen (18) month period.

Q. PLEASE DISCUSS SCE&G'S RATE 35 TRANSPORTATION AND STANDBY SERVICE TARIFF.

In PGA Docket No. 2007-5-G, Order No. 2007-595 dated September 6, 2007, the Commission approved a revised tariff sheet for Rate 35 Transportation and Standby Sales Service. The tariff change required customers served under this rate schedule to make an annual contractual election of: (a) Transportation Service only; (b) Transportation Service with Standby Service; or (c) Standby Service only. The annual nomination is due to the Company each year in writing by October the fifteenth (15th). The election is then effective for each month during the next year beginning November 1st. All elections are binding for the duration of these twelve (12) months. SCE&G has informed ORS that all customers chose option "b", Transportation Service with Standby Service. Since November 2007 was the first time customers served under this rate were subject to the election requirement, the Company and ORS continue to review the operation and service provided under this rate.

Q. DOES THIS CONCLUDE YOUR PREPARED TESTIMONY?

A. Yes, it does.